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TREASURY FOR DEPUTY SECRETARY KIMMITT

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TAGS: PREL PGOV ECON EFIN EAID IZ
SUBJECT: TREASURY DEPUTY SECRETARY KIMMITT,S DISCUSSIONS WITH KEY IRAQI ECONOMIC OFFICIALS

Classified By: EMIN - Marc Wall, Reason E.O. 12958 1.5 (b,d)

¶1. (SBU) Summary: Deputy Secretary of Treasury Robert Kimmitt had a series of meetings with key Iraqi economic officials at events surrounding the Dialogue on Business and Investment Climate (DBIC), including a large dinner hosted by Finance Minister Bayan Jabr at his home in the International Zone on the evening of October 31, 2008, and a breakfast on November 1 hosted by Vice President Adel Abdul-Mahdi, a former finance minister. These events were attended by senior officials on both sides, including Ambassador Ryan Crocker, CETI Coordinator Ambassador Marc Wall, Central Bank Governor Sinan al-Shabibi, and Minister of Planning and Development Cooperation, Ali Baban. During these meetings, a wide variety of economic issues were discussed, including investment issues, fiscal policy and the IMF program. End Summary.

Foreign Investment Issues

¶2. (SBU) D/S Kimmitt made the point that successful conclusion of a Status of Forces Agreement (SOFA) will have positive implications for investment. If Iraq is unable to conclude a workable agreement with the United States, investors are likely to conclude that they too will have trouble structuring satisfactory agreements with the GoI. Iraqi interlocutors, including VP Mahdi and Minister Jabr, concurred with this conclusion.

¶3. (SBU) D/S Kimmitt noted that U.S. funds alone could not rebuild Iraq, as had been shown in the 2003 - 2006 period. Moreover, the GoI could not satisfy Iraq's needs, even on the back of record oil prices in 2007 and 2008. With the hundreds of billions of dollars needed to rebuild Iraq's industry and infrastructure, investment was needed as a source both of expertise and capital. The DBIC would be a good opportunity for Iraqi government officials to better understand what was needed to make Iraq more attractive as a target for investment, and to develop a program to address these issues.

¶4. (SBU) Finance Minister Jabr reported that Iraq has satisfied the qualifications of the Multilateral Investment Guarantee Agency (MIGA), a member of the World Bank Group. Iraq's membership in MIGA will allow investors in Iraq to apply for MIGA political risk insurance on their investments in Iraq.

¶5. (SBU) CBI Governor Shabibi noted that Iraq had also agreed to abide by the IMF's Article VIII foreign exchange convertibility standards. This standard is often described as full convertibility for current account transactions. While most "bricks and mortar" investment falls outside the definition of current account transactions, it is indicative of the success of Iraq's open foreign exchange environment. TREASATT noted that several countries in Eastern Europe in

the 1990s had opened their economies to foreign investment, but had continued to restrict foreign exchange flows. This left investors with profits which could not be repatriated, something which deterred investment.

Monetary Issues

¶6. (C) CBI Governor al-Shabibi told Kimmitt that the central bank is under pressure from other Iraqi officials to allow its reserves to be used for fiscal purposes. In particular, with declining oil prices, the Finance Ministry is looking for other potential pools of funds to tap. Kimmitt noted that Shabibi should consider ways to help protect the CBI's reserves from political pressures. For example, the creation of a savings fund or stabilization fund may help insulate reserves from demands to spend the money. Kimmitt noted to several Iraqi officials that Iraq needs a strong cushion of reserves to protect the currency and that fiscal balances rather than reserves should be the first resort for dealing with potential budget deficits. (Note: The Iraqi Finance Ministry and various spending units are reputed to have funds in bank accounts of over $45 billion. The Central Bank has another $40 billion in its foreign exchange reserves.) Shabibi noted that some Iraqi officials do not put enough importance on Iraq's ability to keep the dinar exchange rate stable.

¶7. (C) When asked, CBI Governor al-Shabibi confirmed that he had been re-appointed for another five-year term. He acknowledged that there was a gap between the end of his first term and his re-appointment for a second five-year

term, but this all related to legislative inertia, and not opposition to his continued service in this role. When asked about a Council of Representatives vote, al-Shabibi claimed that the CBI Governor only needs a vote of the Presidential Council for confirmation.

Fiscal and IMF Issues

¶8. (SBU) Finance Minister Jabr noted strong growth in GoI budgetary resources. Asked about GoI plans to re-build Iraq, Finance Minister Jabr noted that the original base GoI budget for 2008 was nearly $50 billion, predicated upon a $59/bbl price for oil exports. Based on increasing oil prices, the GoI was able to add a $22 billion supplemental budget on top of that, increasing the 2008 expenditure envelope to $72 billion. When the initial 2009 budget was formulated this year, the plan called for expenditures of $79 billion, based on an $80/bbl oil price. This budget represented a dramatic increase in Iraq's government spending, with planned outlays nearly doubling from the $41 billion budget in 2007.

¶9. (C) However, with world oil prices halved from the $140/bbl high earlier in the year, Minister Jabr indicated that such budgetary largess could not be sustained. After meeting with the IMF in late October, Minister Jabr agreed to cut the 2009 budget by 16 percent to approximately $67 billion. This new budget will be developed around projected Iraqi exports of 2.0 million barrels per day and a $62.50 price per barrel, providing estimated revenue of $46 billion. However, Jabr provided only limited details regarding where cuts will occur. With generous public sector pay raises granted in 2008, and provincial elections slated for early 2009, he said it would be difficult to achieve significant cuts in the operating budget. The temptation would be to hollow-out the capital budget; however, Jabr pledged to keep the capital budget at the $15 billion level. He added that it will be a difficult balancing act to shepherd this new budget through the Council of Ministers and the Council of Representatives, especially as it may become a vehicle for regional political disputes.

¶10. (C) In subsequent conversations, Minister Jabr confirmed that his strategy for reducing the operating budget is to reduce transfers to the Public Distribution System (PDS) based on lower agricultural commodity prices. Pay increases for workers in state-owned enterprises - which are off-budget, but which affect subsidy levels - will be reduced or deferred, and in some cases canceled. He is considering a 20 percent across-the-board cut in capital expenditures, but individual ministries may experience deeper cuts. He added that the security ministries - Defense and Interior - will experience budget cuts, but they will be relatively less than other ministries.

¶11. (C) Minister Jabr confirmed that Iraq and the International Monetary Fund remain in agreement that the draft 2009 budget needed to be cut given the fall in oil prices. This will pave the way for a successful conclusion of the current IMF program in March of 2009, which in turn, unlocks the final round of Paris Club debt relief. Asked about Iraq's future relationship with the IMF, Minister Jabr said that he was strongly considering a new IMF program that would include "hard conditionality" and IMF Board review. Both Jabr, and his Senior Advisor Azez Jafar, emphasized that the IMF agreement was one of the few effective tools they had to rein in excessive governmental spending. He planned to negotiate the new program after the current program expires. However, Jabr noted that many in the Government did not feel the same way, and they would press to limit Iraq's relationship with the Fund to the annual Article IV Review.
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